

amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Section, 450 5th Street NW., Washington, DC 20549. Copies of such filing also will be available for inspection and copying at the principal office of NSCC. All submissions should refer to File No. SR-NSCC-95-11 and should be submitted by September 14, 1995.

For the Commission by the Division of Market Regulation, pursuant to delegated authority.<sup>11</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

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[Release No. 34-36115; File No. SR-NASD-95-33]

**Self-Regulatory Organizations; Notice of Filing and Order Granting Partial Accelerated Approval of Proposed Rule Change by National Association of Securities Dealers, Inc., Relating to Actions Taken During Extraordinary Market Conditions**

August 17, 1995.

Pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on July 21, 1995, the National Association of Securities Dealers, Inc. ("NASD" or "Association") filed with the Securities and Exchange Commission ("SEC" or "Commission") the proposed rule change as described in Items I, II, and III below; Items I and II have been prepared by the NASD. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons. As discussed below, the Commission has also granted accelerated approval to a portion of the proposal.

**I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change**

The NASD seeks the authority to modify temporarily the operation of its SelectNet service and its Small Order

Execution System ("SOES") during periods of unusually high Nasdaq broadcast volume. Specifically, the NASD proposes that, during periods with a high number of quotation updates, SelectNet broadcast orders and/or trade reports, it be permitted to take the following action without having to file a proposed rule change with the Commission:

(a) Suspend the entry of SelectNet broadcast orders from 9:30 to 10:30 a.m.;

(b) Execute immediately matched or crossed customer limit orders in the SOES limit order file (*i.e.*, rather than delay execution for five minutes); and

(c) Increase from five minutes to ten minutes the standard grace period in which market makers must refresh their SOES minimum exposure limit.

The NASD requests the Commission to find good cause, pursuant to Section 19(b)(2) of the Act, for approving the proposed rule change prior to the thirtieth day after publication in the **Federal Register**.

**II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change**

In its filing with the Commission, the NASD included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. The NASD has prepared summaries, set forth in Sections (A), (B), and (C) below, of the most significant aspects of such statements.

**(A) Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change**

**1. Purpose**

Pursuant to article VII, section 3 of the NASD By-Laws, a special committee of the NASD Board of Governors was convened on July 20, 1995 to authorize action regarding the operation of certain Nasdaq automated systems. Article VII, section 3 permits a committee consisting of the Chairman, an Executive Committee member and the President of the NASD, in lieu of full Board consideration, to take immediate action when extraordinary market conditions exist.<sup>3</sup> Extraordinary market

conditions are such conditions where the market is experiencing highly volatile trading conditions that require prompt intervention to permit continued efficient operation of the market. Until the new network<sup>4</sup> is completely implemented later this year, and as long as Nasdaq continues to experience trading activity exceeding the existing network's stated capacity of 450 million shares per day, the NASD believes Nasdaq must be considered to be experiencing extraordinary market conditions that must be immediately addressed by appropriate steps that will permit the continued efficient operation of the market.<sup>5</sup>

Therefore, until the new network is fully implemented, the special committee of the NASD Board authorized the following actions to be taken to permit its network to operate efficiently during such periods as the Nasdaq market is experiencing, or reasonably anticipates, heavy trading activity in excess of 450 million shares per day:

1. Between the hours of 9:30 to 10:30 a.m., SelectNet orders must be directed to specific market makers;

2. The standard grace period for a market maker in a National Market security to restore its minimum exposure limit in SOES will be expanded from five minutes to ten minutes; and

3. Priced orders entered into the SOES limit order file on the opposite side of the market from each other that match or cross in price will be executed against each other immediately rather than after five minutes.<sup>6</sup>

The NASD seeks to be able to implement these changes under the described conditions without having to submit a proposed rule change with the Commission each time it implements one of these changes. Under the NASD's emergency authority, the NASD is required, among other things, to file a proposed rule change under section 19(b)(3)(A) promptly after exercising this authority.<sup>7</sup> Under section

participation in any such system of any or all persons or the trading therein of any or all securities. See NASD Securities Dealers Manual ¶1182A.

<sup>4</sup> That is, the migration from Nasdaq Workstation I to Nasdaq Workstation II.

<sup>5</sup> For example, on Wednesday, July 19, 1995, the NASD experienced its highest trading volume ever, 597.5 million shares. In addition, quotation updates were up to four times higher than the previous peak update traffic.

<sup>6</sup> The NASD notes that the Committee also authorized and approved the actions and regulatory changes described above for the extraordinary market conditions experienced on July 19-21, 1995.

<sup>7</sup> Securities Exchange Act Release No. 26072 (Sept. 12, 1988), 53 FR 36143 (Sept. 16, 1988) (order

Continued

<sup>11</sup> 17 CFR 200.30-3(a)(12) (1994).

<sup>1</sup> 15 U.S.C. 78s(b)(1) (1988).

<sup>2</sup> 17 CFR 240.19b-4 (1994).

<sup>3</sup> In the event of an emergency or extraordinary market conditions, Article VII, Section 3 permits the NASD to take any action regarding the trading in or operation of the over-the-counter securities market, the operation of any automated system owned or operated by the NASD, and the

19(b)(3)(A), an NASD proposal becomes effective upon filing with the Commission, but is subject to abrogation by the Commission within 60 days.<sup>8</sup>

The NASD believes these modifications to the operation of its systems and rules associated with its systems are necessary and appropriate for the protection of investors and to maintain the orderly operation of the Nasdaq Stock Market as long as it continues to experience the extremely high levels of trading activity (which includes quotation updates, trade executions through automated execution systems operated by Nasdaq, cancellations of orders, and trade reporting) associated with 450 million share days, and the new network is not yet fully implemented. As a prophylactic measure until the new network is in place, therefore, the NASD will operate its market with these changes (or a subset thereof, at the NASD's discretion) in effect unless market conditions subside to an average daily trading volume of less than 450 million and the associated network traffic drops to acceptable levels.<sup>9</sup>

The NASD states that during periods when these procedures have been implemented, the Nasdaq operations have continued to experience accurate and timely quotations. The primary concern of the NASD during these extraordinary market conditions has been to maintain the accuracy and timeliness of its pricing mechanism. All executions of customer orders, whether such orders are delivered to member firms by means of the telephone, SOES, SelectNet, or member firm internal execution systems, are ultimately driven by the Nasdaq quotation. Therefore, the NASD believes it is essential to price discovery and market integrity that Nasdaq maintain the validity of the quotations it displays.

The NASD believes the modification to SelectNet is the most prudent possible change to Nasdaq services that provides the greatest benefit to system capacity while having the smallest effect on investors. SelectNet messages generally consume greater amounts of

network capacity than other messages sent through the network. By eliminating the broadcast feature of SelectNet,<sup>10</sup> the network obtains approximately 20 percent more capacity than when broadcast messages were permitted. Compared to any other option, the elimination of the broadcast of a SelectNet message provides the most significant capacity benefits to the network.

The NASD believes the immediate execution of matched or crossed limit orders in SOES provides two benefits. First, it permits customers that place priced orders in the file an increased opportunity for rapid execution of their orders, a measure that should be beneficial in heavy trading days. Second, the step provides some minor benefit to the network capacity constraints in that it eliminates a small number of last sale reports that would have occurred had the orders been executed separately.<sup>11</sup>

The NASD also notes that the change to the standard grace period is also important to the overall well-being of the market during these conditions. Because of the extraordinary levels of market activity that are occurring, member firm trading desks are extremely busy handling the multiple points of order flow; Because of the extent of such activity at the trading desks, the NASD fears that the standard grace period of five minutes to update the market maker's minimum exposure limit in SOES is not sufficient to provide market makers a reasonable opportunity to update their exposure limit. If the market maker fails to update the exposure limit in a security within five minutes under current SOES rules, the market maker may be deemed to have withdrawn as a market maker in that security.<sup>12</sup> In extraordinary market conditions, the NASD believes that it would be unwise to lose the liquidity provided by a market maker because such market maker was unable to direct attention to its exposure limit within five minutes. Accordingly, the NASD has determined to expand the standard grace period to ten minutes.<sup>13</sup>

approving proposed rule change to provide the NASD Board of Governors and a proposed committee the authority to take action during extraordinary market conditions). The NASD is also required to use best efforts to consult with the Commission in advance of exercising its emergency authority, provide the Commission with a written report describing the action taken and the reasons therefore, and prepare and maintain with its corporate records a record of any actions taken under the proposed rule change.

<sup>8</sup> 15 U.S.C. 78s(b)(3)(C).

<sup>9</sup> The NASD will provide its Board and the SEC with regular updates on the status of these actions and the need for continuation of these special measures.

<sup>10</sup> By "broadcast," it is meant that a single order is broadcast over the network to all available market makers. The broadcasting of a message of such length to multiple sources consumes significantly more capacity than a message directed to a single point. Thus, limiting SelectNet to directed orders minimizes network traffic while continuing to allow a firm to communicate an order directly to an individual market maker.

<sup>11</sup> Letter to Mark Barracca, Branch Chief, SEC, for Richard G. Ketchum, Chief Operating Officer and Executive Vice President (July 31, 1995).

<sup>12</sup> See SOES Rules of Procedure, (c) 2.(G). NASD Securities Dealers Manual ¶ 2460.

<sup>13</sup> The NASD has taken similar action in other extraordinary market conditions. See e.g., Securities

## 2. Statutory Basis

The NASD believes that the proposed rule change is consistent with the provisions of section 15A(b)(6) of the Act<sup>14</sup> in that the proposed changes are designed to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing, information with respect to, and facilitating transactions in securities, to remove impediments to and perfect the mechanism of a fair and open market. The actions taken by the NASD and proposed herein facilitate the continued operation of the systems during those periods of extraordinary market conditions until the expanded network is ready to be fully implemented.

### (B) Self-Regulatory Organization's Statement on Burden on Competition

The NASD does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act, as amended.

### (C) Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received From Members, Participants, or Others

Written comments were neither solicited nor received.

## III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Within 35 days of the date of publication of this notice in the **Federal Register** or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

A. By order approve such proposed rule change, or

B. Institute proceedings to determine whether the proposed rule change should be disapproved.

The NASD has requested, however, that the Commission find good cause pursuant to section 19(b)(2) for approving the proposed rule change prior to the 30th day after publication in the **Federal Register**.

As discussed below, the Commission finds that the portion of the proposed rule change that modifies the operation of SOES to execute immediately matched or crossed customer limit

Exchange Act Release No. 27369 (Oct. 19, 1989), 54 FR 45832 (Oct. 31, 1989) and Securities Exchange Act Release No. 29664 (Sept. 10, 1991), October 1989 Market Break and the political upheaval in the former Soviet Union in August 1991.

<sup>14</sup> 15 U.S.C. 78o-3.

orders in the SOES limit order file is consistent with the requirements of the Act. Further, the Commission finds good cause for approving, prior to the 30th day after the date of publication of notice of filing in the **Federal Register**, the proposal to execute immediately matched or crossed limit orders in SOES. The Commission believes that accelerated approval of this portion of the proposal will benefit investors by creating a greater assurance that the Nasdaq market will continue to operate efficiently during periods of market stress and high volume.

#### **IV. Commission's Findings and Order Granting Partial Accelerated Approval of Proposed Rule Change**

The Commission finds that the proposal to permit the NASD to modify the operation of SOES to allow matched or crossed customer limit orders in the SOES limit order file to execute immediately against each other (*i.e.*, rather than be delayed for five minutes) is consistent with the Act and the rules and regulations promulgated thereunder. Specifically, the Commission finds that the proposed rule change is consistent with the requirements of Section 15A(b)(6) which requires that the NASD rules be designed, among other things, to facilitate securities transactions and protect investors and the public interest. Removing the five-minute delay in the execution of matched or crossed limit orders in the SOES limit order file will facilitate the NASD's load shedding efforts by increasing the speed of execution and removing orders from the Nasdaq system more quickly. Moreover, the greater likelihood that an investor will receive an execution of a limit order placed in SOES may encourage greater use of the SOES limit order file. This will further decrease the burden on market makers and increase the message handling capabilities of Nasdaq during high volume periods. Finally, the Commission notes that the proposal will further the Congressional objective to increase the opportunity for investors' orders to be executed without the participation of a dealer.<sup>15</sup>

Nonetheless, the Commission is concerned about the effects of service changes on the Nasdaq market. Accordingly, the Commission directs the NASD to notify, prior to implementing this change to SOES or as soon as practicable thereafter, its members via the Nasdaq Workstation and the staff of the Division of Market Regulation by telephone. In addition, on a weekly basis, the NASD should submit

a written report to the Division of Market Regulation providing information on any service changes since the last report.<sup>16</sup> The information provided should include: (a) a brief description of the change; (b) the event(s) triggering the change; and (c) the NASD's assessment of the effect of the change on the Nasdaq system.

As a more general matter, the Commission is concerned about capacity limitations in the Nasdaq system. Since 1989, the Commission has urged self-regulatory organizations, among other things, to develop current and future capacity estimates, conduct capacity stress tests, and contract with independent reviewers to assess annually whether their systems can perform adequately under varying degrees of market activity.<sup>17</sup> While the Commission recognizes that the NASD expects that its planned system changes will address these issues, we are concerned about the ongoing stress in the Nasdaq system, as well as the inability to resolve that stress without service reductions. Accordingly, the Commission has requested the NASD to obtain an independent review of its current capacity.

#### **V. Solicitation of Comments**

Interested persons are invited to submit written data, views, and arguments concerning the foregoing. The Commission specifically requests that commenters address the appropriateness of the NASD's approaches to address system capacity during periods of market stress. The Commission shares the NASD's concerns about timely and accurate quotes and trade reports in high volume market conditions. While the Commission understands that suspending SelectNet's broadcast feature during high volume markets will free up broadcast capacity, the Commission requests that the NASD elaborate on the effects of this modification on quotes and trade reports. In this regard, it would be helpful if the NASD and market participants described their experience over the past month with the timeliness and accuracy of quotes and trade reports during SelectNet broadcast suspensions.

In addition, the NASD has stated that suppression of the SelectNet broadcast

feature offers the greatest benefits in terms of system capacity with the least effect on investors. The Commission invites comment on the implications of this modification for investors and firms in terms of market access, execution quality, transparency, and price discovery. The Commission also invites comment on whether there may be alternatives available for improving system capacity that would have a smaller impact on market participants.

The Commission also seeks comments on the NASD's proposal to double the length of the standard grace period in which market makers must refresh their SOES minimum exposure limit. SOES—with mandatory market maker participation and an automatic twenty-day suspension for failure to refresh exposure limits within the grace period—was enhanced in 1988 to provide small investors with access to market during periods of extraordinary activity. In the pending proposal, the NASD wishes to reduce the availability of SOES under precisely those conditions. The Commission invites comment on whether this proposal undermines the purpose of SOES and any relevant experience from either of the last two times that the NASD extended the grace period.

The Commission also notes that the practical effect of the NASD's proposal is to limit the availability of automatic execution in order to protect the liquidity of the overall market. That is, market makers will be permitted to remain active in a security despite more lengthy periods of inactivity on SOES. The Commission solicits comments on whether there are alternatives available that would continue the availability of automatic executions for small orders that would not have a negative impact on the liquidity of the overall Nasdaq market. For example, given the availability of auto-refresh in the Nasdaq market, comments are invited on whether such a system is adequate to address this concern, and whether private systems exist that can notify market makers when they have been executed against the SOES and are about to be taken off the screen because of the expiration of the grace period.

Finally, given that the NASD will implement these changes based on its continuing assessment of market conditions and the need to implement any one or any combination of the changes, comment is invited on the potential for confusion, both to investors and to other market participants as to which changes are in place on any given day and the implications of these changes for trading in the over-the-counter market.

<sup>15</sup> *Id.* section 78k-1(a)(1)(C)(v).

<sup>16</sup> The NASD's notification via the telephone and its written report to the Commission should be directed to the Branch Chief, Office of Automation & International Markets, Division of Market Regulation or his designee.

<sup>17</sup> Securities Exchange Act Release No. 29185 (May 19, 1991), 56 FR 22490 (May 15, 1991) and Securities Exchange Act Release No. 27445 (Nov. 16, 1989), 54 FR 48703 (Nov. 24, 1989).

Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street NW., Washington, DC 20549. Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room. Copies of such filing will also be available for inspection and copying at the principal office of the NASD. All submissions should refer to the file No. SR-NASD-95-33 and should be submitted by September 8, 1995.

*It is therefore ordered*, pursuant to Section 19(b)(2) of the Act, that the portion of the proposed rule change (SR-NASD-95-33) providing the NASD the authority to modify the operation of SOES by allowing matched or crossed limit orders to execute automatically is approved until January 5, 1996 or the completion of the roll-out of Workstation II, whichever occurs first.

By the Commission.

**Margaret H. McFarland,**

*Deputy Secretary.*

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[Release No. 34-36114; File No. SR-PHLX-95-50]

**Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by the Philadelphia Stock Exchange, Inc., Relating to PHLX Rule 722, "Margins"**

August 17, 1995.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"), 15 U.S.C. 78s(b)(1), notice is hereby given that on July 3, 1995, the Philadelphia Stock Exchange, Inc. ("PHLX" or "Exchange") filed with the Securities and Exchange Commission ("SEC" or "Commission") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the self-regulatory organization. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

**I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change**

Currently, PHLX Rule 722(c)(6), "Time Within Which Margin or 'Mark-to-Market' Must Be Obtained," provides that margin for a short foreign currency option ("FCO") position in a customer account or full cash payment for a long FCO position in a customer account must be obtained within seven business days following the date on which the customer enters into the FCO position. Recently, the Board of Governors of the Federal Reserve System ("Board") amended Regulation T under the Act to reduce from seven business days after the trade date to five business days after the trade date the amount of time in which a customer must meet initial margin calls or make full cash payment for securities.<sup>1</sup> To be consistent with Regulation T, as amended, the PHLX proposes to amend Exchange Rule 722(c)(6) to reduce from seven business days to five business days the time in which a customer must either pay for a long FCO position or post initial margin for a short FCO position.

The text of the proposed rule change is available at the Office of the Secretary, PHLX, and at the Commission.

**II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change**

In its filing with the Commission, the self-regulatory organization included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. The self-regulatory organization has prepared summaries, set forth in sections (A), (B), and (C) below, of the most significant aspects of such statements.

<sup>1</sup> Regulation T, as amended, provides that a margin call must be satisfied within one payment period after the margin deficiency was created or increased. Under Regulation T, a "payment period" is the number of business days in the standard securities settlement cycle in the United States, as defined in SEC Rule 15c6-1 under the Act, plus two business days. As of June 7, 1995, SEC Rule 15c6-1 establishes a standard three business day settlement cycle for most securities transactions in the United States. Accordingly, after June 7, 1995, the payment period for satisfying a margin call under Regulation T is five business days.

**(A) Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change**

Commission Rule 15c6-1, which became effective on June 7, 1995,<sup>2</sup> reduced the standard time for securities settlement from five business days ("T+5") to three business days ("T+3"). At the same time, the Board amended Regulation T under the Act to define the payment period in which a margin call must be satisfied or a cash payment received as two business days after the standard securities settlement cycle. According to the PHLX, T+3 has impacted securities trading in many ways, primarily in the systems and procedures utilized by broker-dealers, exchanges, and clearing agencies.

In addition, the Exchange states that PHLX Rule 722 has been impacted by T+3. Specifically, PHLX Rule 722(c)(6) currently provides that FCO margin and cash payment must be obtained as promptly as possible but before the expiration of seven full business days following the trade date. This time period was originally established by allowing two days after the regular T+5 settlement time for securities. With T+5 reduced to T+3, the Exchange proposes to reduce the time period by which margin or cash payment must be obtained to five business days.

The purpose of the proposed rule change is to reduce the payment period to correspond to the recent amendments to Regulation T. However, the Exchange notes that this time period is a maximum, as PHLX Rule 722(c)(6) requires the payment of margin "as promptly as possible." According to the PHLX, most Exchange member firms clearing FCO trades require payment to be paid or margin collected by the date following the trade.

The Exchange believes that the proposal is consistent with Section 6 of the Act, in general, and, in particular, with section 6(b)(5), in that it is designed to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities, by reducing the time frame for margin or cash payment to reflect the reduced securities settlement time period.

**(B) Self-Regulatory Organization's Statement on Burden on Competition**

The PHLX does not believe that the proposed rule change will impose any inappropriate burden on competition.

<sup>2</sup> 17 CFR 240.15c6-1.